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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of)
)
Price Cap Performance Review) CC Docket No. 94-1
for Local Exchange Carriers)

Initial Comments of the
INTERNATIONAL COMMUNICATIONS ASSOCIATION

Introduction and summary

The International Communications (ICA) hereby submits its initial comments concerning the Notice of Proposed Rulemaking in the above captioned matter.¹ ICA urges the Commission to modify the current interstate LEC price cap plan to accomplish four objectives:

- First, ratepayers should receive greater economic benefits; at least part of these benefits should take the form of an initial rate reduction at the beginning of the second plan period in order to recognize the excessive apportionment of price cap benefits to LECs in the current plan.
 - The minimum productivity factor for LECs in the plan should be raised to at least 5.5% per year, or higher if the record warrants it.

¹ Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, NPR, FCC 94-10 (adopted Jan. 19, 1994, released Feb. 16, 1994) (Notice).

- The "consumer productivity dividend" should be increased to 0.75% at the start of the second plan and raised to 1% two years thereafter.
- To compensate for initial mis-specification of the productivity factor, particularly regarding input prices, an initial 3% interstate revenue decrease should be applied to LEC rates, either across-the-board or by means of one-time adjustments to Carrier Common Line Charges and Residual Interconnections Charges.
- Second, selected aspects of the price cap plan should be explicitly designed to reduce LECs' incentives and ability to "game" regulatory rules to their benefit.
 - Much more stringent rules should be applied to any exogenous cost adjustments.
 - Rather than simply deferring cost reviews for new LEC services, the Commission should create a new "price linking" mechanism so that all services, not just an LEC's favored new services, may potentially share in additional price reductions.
 - Infrastructure funding additives, reflecting some ill-defined notion of "supply-side" economics, should not be included in the plan.
 - Alternatively, any "infrastructure" additive should be targeted to specific areas affecting consumer demand but not LEC network resources, conducted under competitive procurement rules, and subject to matching funds from non-ratepayer sources.
- In order to make the most efficient use of the Commission's scarce resources, issues generally applicable to all LECs or to other segments of the telecommunications industry should be addressed outside of price caps.

- Issues such as universal service and service quality, which already are the subject of separate Commission proceedings, should not be engrafted upon the structure of the LEC price cap plan but should continue to be addressed on their own terms.
- New Commission monitoring of LEC-interconnected wireless, coaxial or other facilities and monitoring the evolution of the facilities provided by vendors other than LECs deserve to be treated in a separate proceeding focused upon this issue.
- Finally, elements of the plan should be revised so as to incorporate stronger competitive market incentives upon the LECs. ICA believes the revised price cap plan should achieve its potential benefits *using competition as a guide* in all cases: Promoting a more open, competitive market in telecommunications services where possible, and where competition remains absent or inadequate, striving to *simulate the same results* that would occur in a competitive marketplace.

The ICA is the largest association of telecommunications users in the world. Recent estimates indicate that ICA members spend about \$21 Billion each year on telecommunications services and equipment. A substantial amount of that money is paid either directly or indirectly to LECs for services subject to the interstate price cap plan. The bylaws of the ICA exclude any firm that is predominantly engaged in the production, sale or rental of communications services or equipment from eligibility for membership. ICA members are large users of each and every type of existing or potential service offered by the local telephone carriers subject to this proceeding.

General Issue 1: Should the Commission revise the goals of the LEC price cap plan to better achieve the purposes of the Communications Act and the public interest, and if so what should be the revised goals?

The existing price cap goals, summarized in paragraph 31 of the Notice, are generally sufficient. As the Commission notes in several places (see e.g.,

paragraphs 45 and 99), the efficacy of any regulatory plan may be compromised by frequently changing the rules of the game. In the same way, revising the fundamental goals of price cap regulation risks destabilizing the system. This risk is particularly acute if the Commission were to inject additional ill-defined social policy or "infrastructure development" objectives into the plan. As ICA indicates throughout these comments, we believe that the Commission erred in the initial plan by creating regulations that were too generous to LECs. The Commission's first mandate is to protect ratepayers and to prevent local carriers with market power from unduly exercising that market power. The current LEC price cap plan's grasp of this mandate is strained at best. It would be wrong to further attenuate the plan's ratepayer protection features in favor of a "supply-side" economic policy designed to encourage network investment or to extend "universal service" to telecommunications capabilities that many consumers may not want.

ICA believes that revisions to the plan should seek to better leverage existing market place forces applicable to the LECs and to reflect marketplace surrogates where actual market forces are inadequate. LECs are subject to market place forces in areas like public capital markets. Nothing the Commission does in this proceeding should reduce the influence of these effects on LECs. LECs traditionally have been subject to competitive forces in capital markets, as long as regulation does not provide a rate of return that is too high or too low. By most measures, current LEC earnings are quite high relative to returns in competitive capital markets. Therefore, the LECs' price cap should be reset so as to ensure that LEC earnings are no higher than returns realized in the overall competitive capital market. Not to reset the current rate levels would perpetuate the large share of excess earnings that LECs have achieved by means of an overly-generous regulatory system, rather than becoming more efficient.

Additionally, for newer, non-basic services, LECs should be subject to the same marketplace discipline as firms subject to full competition. That is, regulation should not provide LECs with a safe haven if the demand for newer, non-basic services develops more slowly than anticipated, or fails to develop at all.

As noted, ICA generally agrees with the Commission's observation concerning the potential dis-incentive effects of making too frequent changes in the structure of the price cap plan. This is, in fact, a valid objective for any regulatory plan, not just price caps. The changes in the plan we propose here are designed to allow the FCC to extend the plan for the next four-year review period or perhaps longer. The plan will become more sustainable by incorporating additional indexing mechanisms and relying upon more objective productivity data to assess both the LECs' recent performance and to set productivity targets for the revised plan.

General Issue 2: Quantify the effects of the plan and possible revisions to it on jobs, lower costs of telecom, effects on profits of LECs and CAPs.

The local exchange carrier industry is undergoing a sustained reduction in the number of jobs. This trend began before the development of the interstate price cap plan, or alternative regulation plans at the state level. It is continuing today. In the last five years, the RBOCs have reduced the number of employees per access line at the compound annual rate of 3.4%.² Such trends can be magnified, if FCC regulation offers LECs better incentives to become more efficient.

LECs deserve credit for these efforts to become more efficient, as long as their obligations to improve service quality and network reliability are not adversely affected. However, the Commission should give little weight to LEC claims that more generous regulatory rules for them will create benefits outside their sector in the overall U.S. economy. LECs have made such claims in a number of state regulatory proceedings in the last few years, and ICA understands that similar economic analyses will be submitted in this proceeding.

ICA will review any such studies carefully. However, the Commission properly should be skeptical of such claims. If the LECs attribute macroeconomic benefits to their reinvestment of excess profits from interstate access into other business

² Source: FCC Statistics of Common Carriers.

ventures, the Commission should determine why those potential benefits would not also be realized by new debt and equity financing raised in public securities markets — rather than just through internal cash flow. The Commission should determine whether the economic stimulus identified in any LEC studies adequately accounts for the benefits achievable from the alternative of lower LEC prices. Market forces are more likely to efficiently allocate the benefits of reduced LEC prices by means of the savings and consumption decisions of LEC ratepayers. The Commission should also analyze whether any linkage identified by LEC studies between telecommunications development and overall development of the economy has been or could be replicated using publicly available data and data from other sources, such as international comparisons.

Job gains among information-intensive businesses will be directly stimulated by lower LEC prices. Every dollar spent upon LEC access services at prices that are higher than efficient prices in a competitive market is a dollar that cannot, and will not, be spent creating new jobs in the information sector. Lower access prices will eventually translate into lower long distance rates. Lower prices for services based upon new technologies or capabilities will accelerate users' propensity to adopt new technology sooner. Technology is causing communication and information services costs to steadily decrease over time. Tariff prices for services provided through such technologies generally should decrease at the same time; it is not always sufficient merely to control the rate at which inflation-adjusted prices increase.

Failure to adhere to local telephone and interstate access prices that reflect the declining costs of technology could distort the organization of the U.S. telecommunications and information industries as well. Excess prices for communications services will lead to the dominant LECs realizing ever-higher margins, and the resulting cash flow could be diverted to internally finance strategic investments that should be funded separately through public securities markets. If LEC cash flow is directed towards investments in competitive or foreign markets, replacing financing that should be raised in competitive capital markets, the result may simply be their unwarranted dominance over vital new sectors of America's high technology industries.

Baseline Issue 1: Whether and, if so, how the Commission should revise the LEC price cap plan to support development of a ubiquitous national information infrastructure?

ICA believes that it is highly inappropriate for the LEC price cap plan to be converted into some sort of "supply-side" stimulus to the alleged economic development effects of the telecommunications infrastructure. Increased competition will provide a more efficient mechanism for transferring advanced telecommunications and information technologies into the national economy. Therefore, ICA believes that the price cap plan should not contain an explicit infrastructure element. However, if the FCC determines that such an element ought to be considered, ICA believes that it should meet the several criteria. Attachment A to ICA's comments discusses these issues in greater depth.

"Infrastructure" funding should exclude direct additional funding of LEC network resources, because the FCC will not have the ability to distinguish between network upgrades that are undertaken for strategic purposes benefiting the LEC. In ICA's experience, development of modernized information resources in public institutions, like schools and universities requires ancillary investments in training, support, inside wiring and other areas. Additional funding should be limited to these areas.

Only projects that have been subject to full competitive procurement rules should be eligible for funding. In other words, just because an LEC regulatory plan is the vehicle for funding selected infrastructure projects, the LEC itself need not and should not be the sole or even primary supplier or owner of the resulting facilities. Many providers other than carriers are capable of providing support for advanced information and telecommunications services and these providers should have equal access to any ratepayer supplied funds.

There should be some sort of matching fund concept associated with any public infrastructure project, and a group or groups other than interstate ratepayers should share the funding. The total amount of funds derived from any FCC should be tightly capped at no more than \$20 Million per carrier or holding

company. The regulator of the LEC's intrastate services should approve funding for these ancillary expenditures on training, etc. The interstate mechanism should be subject to the above conditions regardless of the participation of other groups in funding mechanism. Finally, the funding mechanism should always remain exogenous to the LEC price cap plan and subject to prior FCC approval, in keeping with ICA's other recommendations for limiting future exogenous adjustments (Baseline Issue 6a, below).

Baseline Issue 2: Whether the goal of providing universal service to all geographic areas of equal type and quality for all Americans at affordable prices is being met or whether we should revise the plan to ensure the provision of universal service?

ICA generally believes that universal service goals are being achieved at this time. To the extent future adjustments in policies designed to ensure universal service may be considered, the adjustment should occur outside the LEC price cap plan. The Commission already has before it a petition for a review of universal service policies, and ICA and other parties have submitted comments regarding that petition.³

In our comments, ICA warned that "universal service" was in danger of becoming "some form of shibboleth, that may be used, or misused, to support limits on the growth of telecommunications competition or other policies such as the potentially uneconomic adoption of new telecommunications technologies." As to the extension of universal service to new advanced services, ICA believes that the Commission should not try to anticipate the marketplace and consumer demand. Additionally, almost every recent commentator on universal service issues has recognized that any revisions to the current mechanisms must be

³ Petition of Metropolitan Fiber Systems in Re: Policies and Programs To Assure Universal Telephone Service in a Competitive Market Environment, RM-8388, Initial Comments submitted December 16, 1993.

opened up and account for future competition in telecommunications.⁴ It is not appropriate to consider changes in universal service policies in this proceeding, which affects only the LECs subject to the price cap plan.

Baseline Issue 3: Submit data regarding the rate at which price cap LECs are replacing copper plant with fiber optics, bandwidth compression and other technologies.

This issue requests information from price cap LECs; therefore, ICA reserves the right to reply to data submissions by the LECs. Some ICA members have noted instances where an LEC declined to provide fiber optics or other facilities to a specified user site. ICA does not have any information indicating whether such anecdotes from our members represent a general condition. In reviewing what data LECs submit, ICA will be especially interested in examining how LECs' evaluate the expected internal rate of return on specific network upgrade or replacement projects. We believe it would be useful for the Commission to understand how LECs evaluate specific capital projects in general, as well as whether requests by specific customers for, say, the extension of fiber optics to a particular customer location are factored into the economics of the cost/benefit evaluation of capital projects.

Baseline Issue 2: Whether the rules for LEC price cap baskets and bands should be revised, to reflect expected levels of competition among different LEC services or other common characteristics? Does the existing basket structure reflect levels of expected competition?

At paragraphs 40-41 of the Notice, the Commission addresses the possibility of grouping services subject to similar competitive pressures in same baskets. An analogous proposal is addressed under Transition Issue number 3 regarding the process by which future changes in competition should lead to rebalancing the price cap baskets. These concepts have a certain superficial appeal; at some

⁴ See for example, Professor Eli Noam, "NetTrans Accounts: Reforming the Financial Support System for Universal Service in Telecommunications," Columbia University Institute for Tele-Information, discussion draft, November 1993.

level, creating a basket structure that reflects different degrees of competition sounds like an appropriate and responsive regulatory policy. This approach has some theoretical appeal, but it would be hard to implement.

The mechanics of altering baskets according to competition are extremely difficult to define in practice. The USTA proposal discussed in paragraph 39 of the Notice illustrates the problematic nature of these determinations. The USTA proposal, as reflected in section "Y.101" of its proposed rules, allows LECs to designate individual exchange areas as initial, transitional or competitive market areas at any time. Multiple — and in many cases, non-specific — criteria could be used by the LEC to make this determination, under the USTA proposal. Much of the information that an LEC could rely upon to make this type of competitive showing may not be available to other parties or to the Commission from public, verifiable sources. The data is not auditable in any sense of the word.

Therefore, ICA opposes the suggestion that baskets and bands should be re-aligned with respect to the degree of competition. The price cap plan should not be changed in a manner that requires a determination of the level or extent of competition for selected services, because these determinations would be factually intensive and place the Commission in the difficult position brokering interest group disputes. The scope and extent of local competition is likely to be hard to anticipate in advance. The LECs are likely to state that all or most LEC services are or will soon be subject to competition.

The Commission has managed to make revisions to the transport baskets and categories without undertaking a complicated, factual investigation affecting individual LECs or specific conditions in various market areas. Transport Rate Structure and Pricing, Second Report and Order, CC Docket No. 91-213 (January 31, 1994). Other Commission rules, like zone density pricing, have not and do not depend upon the level of competition. To the extent any indicia of competition are used to change the structure or composition of baskets, the data should be objectively verifiable from the actual business records of the LEC. The numbers of circuits interconnected with the LEC could provide this type of verifiable data because the LEC must maintain it for billing purposes. In the Phase

Expanded Interconnection Order,⁵ the Commission did adopt a partial metric for the development of competition, based upon a minimum number of interconnected circuits. This type of metric illustrates the appropriate type of process.

However, the switched transport order applies a test based upon absolute quantities of DS1-equivalent circuits, whereas a percentage of DS1-equivalent circuits interconnected by CAPs is a better type of test. A percentage — instead of an absolute number of interconnected circuits — will permit the Commission to evaluate the degree of competition relative to the overall size and traffic levels in the particular exchange or market area. ICA believes that the minimum percentage should be at least 20%.

Baseline Issue 3a: Whether the productivity factor used to compute the LEC price cap should be changed, or in the alternative whether a one-time reduction in prices should be required; should the plan be modified so as to reflect changes in interest rates. How would these changes preserve or improve price cap incentives?

ICA strongly supports a significant increase in the productivity offset for the LEC price cap plan. A large amount of empirical data now demonstrates that the initial productivity offset of 3.3%, even with its 0.5% "consumer productivity dividend" was too low when established. The X factor is constantly becoming even more outmoded as information technology drives down the economic costs of local telephone service. A substantial amount of the benefits that have been denied to interstate ratepayers under the initial plan arise from increasing competition among the suppliers of equipment, services and software that are the inputs to the LECs productivity performance. Not only have the conditions creating this input price competition long pre-dated the current price cap plan, these conditions cannot be attributed to any regulatory incentives.

As ICA noted, an important test of the effectiveness of the Commission's price cap review is whether the plan can be changed to better emulate a fully

⁵ FCC 93-379, September 2, 1993.

competitive market, i.e., one in which all products or services of a firm are subject to more or less the same competitive pressures. These competitive market incentives do not allow firms to gain from the productivity increases of their suppliers. If the fully competitive firm wants to improve profits and performance it must do so through efforts internal to its own business operations. Even then, of course, its ability to retain the benefits of its own increased innovation or efficiency will be eroded as other competitors respond in kind. The current price cap plan for LECs does not create these types of conditions.

The minimum productivity factor for LECs in the plan should be raised to at least 5.5% per year, or higher if the record warrants it. ICA understands that several parties will submit additional data concerning LEC productivity in this proceeding. The methodology used by the FCC in CC No. Docket 87-313, which developed an X-factor based upon differentials between interstate access prices and the GNP-PI inflation index may have represented the appropriate approach given the data then at hand, but it was not based upon an previously-established economic methodology or studies. Better data and methods are now available, from both the LECs actual performance under the price cap plan and from actual total factor productivity data. These data should be used in lieu of the overly cautious methods used previously. It would also be desirable for the Commission to specify an X-factor for each of the eight or nine largest LEC operations, because the current single average productivity value introduces its own set of incentive distortions. If the record developed in this proceeding adequately supports such differences, they should be considered.

The "consumer productivity dividend" should be increased to 0.75% at the start of the second plan and raised to 1% two years thereafter. Equally important, in order to compensate for the Commission's extreme conservatism and resulting mis-specification of the initial productivity factor an initial one-time adjustment should be made to LEC rates. A one time adjustment is particularly justified at this time in order to redress the lack of record evidence in CC Docket No. 87-313 that the GNP-PI price index accurately reflected actual LEC input prices. Because parties to the initial LEC price cap proceeding were forced to make this assumption, and because the assumption can now be deemed to have been false,

use of the GNP-PI has overstated LEC input prices by one to two percent per year. The added returns realized by LECs due to these errors (rather than their own increased efficiencies), partially reflect this distortion.

Therefore, in order to properly adjust LEC rates on a going forward basis, an initial 3% revenue decrease should be applied to interstate access service rates. The reduction should either be across-the-board or by means of one-time adjustments to Carrier Common Line Charges and Residual Interconnections Charges. IXC's with tariffs on file at the FCC should credit this reduction to customer bills.

ICA believes that either the price index or earning sharing parts of the plan should be indexed for changes in interest rates. It is probably mechanically easier to accomplish this by developing an adjustment factor that would be applied to the earning sharing mechanism. As ICA discusses under Issue 4a, the sharing mechanism should incorporate a cumulative adjustment mechanism to replace the current low-end adjustment and interest rates could be factored into the mechanism as well.

Baseline Issue 3b: Are the profit levels of price cap LECs reasonable under the current plan in light of the goal that higher profits are intended to be a reward for increased efficiencies?

No, because objective productivity data confirms that the rise in LEC earnings is not primarily the result of new-found incentives for increased efficiency.

Baseline Issue 3c: What method should be used for determining a revised, reasonable productivity factor?

As noted, ICA believes that the data and methods used to develop the initial productivity offset for the LEC price cap plan suffered from flaws that should be corrected. In the review phase, ICA believes that the FCC should give substantially more weight to more recent data and to actual calculations of Total Factor Productivity that replicate the methods used by the US Government to calculate Multi-Factor Productivity. Because at least three years of actual LEC data since the implementation of the plan price caps will be available during this

review process, data used to compare LEC with the inflation rate prior to the implementation of the price cap plan should be considered for no more than the three prior years.

Baseline Issue 4a: Whether the sharing and low end adjustment mechanisms should be realigned with changes in capital costs, and if so, how.

These sharing mechanism should not be eliminated, as some LECs may propose. The sharing mechanism was developed by the Commission precisely in order to provide benchmarks about whether the initial plan was appropriately balanced. The data developed by comparing the results under the initial price cap and data on the LEC's earnings levels have, in fact, performed their intended function. The data will show that the initial plan was unbalanced. It unduly favored the LECs. The Commission now has an opportunity to rebalance the plan, but, as in the case of the initial plan, it cannot be sure *a priori* that the revisions strike a proper balance.

A significant number of uncertainties remain concerning the specification of the price cap and the best ways to ensure that the price cap results emulate competitive market results as closely as possible. Earnings tests of the LECs' performance under price caps remain the most effective mechanism for evaluating the results, because the data needed for this benchmark already exist and are being reported by the LECs.

The Commission has never specified a precise set of rules for the low-end adjustment mechanism, and LECs, like NYNEX, who availed themselves of a low-end adjustment in one tariff year have out-performed LECs in other years. Therefore, the low end adjustment mechanism should be eliminated and replaced with an earning sharing indexing scheme. The adjustment should be combined with the sharing mechanism so that a LEC can offset an earnings sharing obligation in one tariff year with its foregone profits from a prior year. In effect, the sharing mechanism should be restated to provide a marketplace test on the LEC's cumulative earnings performance over the second price cap period. The

cumulative earnings bands should be indexed with changes in a broad measure of interest, like US treasury long bonds.

Baseline Issue 4b: Whether the sharing and low end adjustment mechanisms should be revised or eliminated?

See the discussion under Baseline Issue 4a, above.

Baseline Issue 5a: Whether the Commission should reconsider the use of the Balanced 50/50 formula to cap common line charges? Baseline Issue 5b: If so, what method should be used?

Like all other users of LEC access services, ICA supported the per line approach to Common Line (CL) charges in the original LEC price cap proceeding. The revised balanced 50/50 approach adopted by the Commission reduced the windfall gains that the LECs receive under this formulation, but did not eliminate all such windfalls compared to traditional regulation. This artifact of the original compromise should be eliminated, in favor of a clearer set of incentives to reduce costs by using a the appropriate productivity factor for CL charges capped on the per-line basis.

Baseline Issue 5c: If a per-line charge were adopted how should this affect changes in the productivity factor or the composition of baskets, e.g. putting common line charges in a "public policy" basket?

See generally the discussion above. ICA fails to comprehend the logic behind USTA's proposal to create a "public policy" basket, other than a desire to effect as much disruption in Part 69 rules as possible at one time. The concept of a "basket" is intended to offer LECs a span of similar services within which they are afforded a degree of pricing flexibility. On the other hand, the concept of some prices being infused with a special public policy role seems to be inimical to the notion of pricing flexibility. These rate elements are uniquely set by residual pricing techniques or other methods that have nothing to do with efficient pricing, so enabling LECs to adjust "public policy" rate elements in order to better achieve pricing efficiency is a non sequitur. If some services are ultimately designated for

a public policy basket they should be subject to no pricing flexibility, i.e., the price cap should be placed upon each rate element or set of rate elements. Indeed, the logic of a public policy basket may imply that these specific rate elements should not be subject to any inflation-based upward adjustments at all.

Baseline Issue 6a: Should number of cost changes currently eligible for exogenous treatment be reduced?

Yes. ICA supports the proposal to reduce the types and scope of changes that might qualify for treatment.⁶ Experience with exogenous cost changes suggests that there are two parallel conditions that preclude the use of exogenous cost adjustments: (1) When the cost adjustment is sufficiently broad that it is reflected in the inflation index (this was the original limitation on exogenous changes), or (2) when the nature of a "cost" change is sufficiently nebulous that it is not reflected in price changes in any sector of the economy but may instead effect firms' reported earnings (this was the nature of future OPEB changes that were not allowed as exogenous adjustments). These conditions are likely to preclude most exogenous cost changes.

The existing rule invites gaming and strategic behavior by LECs, by allowing them to specify proposed exogenous changes under the general provisions of the rule. Nevertheless, ICA is not able to conclude that exogenous adjustments should be completely excluded in the revised plan. Therefore, the Commission should develop considerably more stringent guidelines governing the filing by a price cap LEC of a potential Z-adjustment. These new rules should:

- Occur only pursuant to a Commission order that was adopted prior to the price cap tariff year;

⁶ Notice, paragraph 62. The Commission proposes to distinguish between accounting changes and factors that affect LECs' economic costs.

- Explicitly require a quantifiable adjustment by the price cap LECs, affecting it actual cash flow, so that accounting adjustments like OPEB changes generally would not be allowed;
- Be cognizable as a ratemaking adjustment under traditional rules (e.g., it is not a fine, penalty or forfeiture);
- Not be based upon a LEC's mere claim that it was "dis-proportionately" affected by a change that is partially reflected in the general rate of inflation (GNP-PI). The LEC should be required to identify and eliminate all offsetting effects in the inflation index.⁷

These requirements should be added to the exogenous cost tests

Baseline Issue 6b: If so, which cost changes ones should be eligible for exogenous treatment?

See ICA's response to Baseline Issue 6a.

Baseline Issue 6c: Should the Commission adopt an administrative process to allow access customers and other groups to request that other cost changes be eligible for exogenous treatment, and if so, how?

ICA would support such an administrative procedure in concept, particularly if the exogenous cost rule is not modified to essentially eliminate a LEC's discretion to try to create new exogenous cost adjustments (as discussed above).⁸ We reserve the right to comment on the specific form of the administrative process,

⁷ For example, an LEC claiming that it suffered costs as a result of a flood in its service territory would have to specifically identify and deduct from its inflation factor all price index effects associated with catastrophic events throughout the U.S. in the same time period, including other floods, hurricanes, earthquakes, ice storms, etc.

⁸ ICA agrees with the Commission's analysis in paragraph 65 of the Notice that the current rules allow LECs to exploit their asymmetrical access to data concerning possible exogenous changes and distort the reporting incentives for LECs.

in the event another party outlines a proposal in this regard. ICA believes, however, that the more restrictive tests for allowing any additional exogenous cost adjustments set out above, may be more effective than, and obviate the need for, a new administrative process designed to give LEC customers symmetrical rights to identify exogenous cost reductions. Under the new rules itemized above, the LEC would have the initial burden of meeting all of the revised exogenous cost tests. This approach places the first responsibility for gathering data on exogenous cost and offsetting savings appropriately on the LECs. Then, instead of creating a formal new administrative process, the Commission's existing complaint and tariff review processes should be sufficient to impose any additional oversight that is required.

Baseline Issue 7a: Whether the Commission should increase or revise monitoring of LEC network reliability, service quality and infrastructure development? Commenters should submit data on the administrative and business costs of their proposals.

ICA supports the current Commission proposals in CC Docket No. 91-273 to improve the reporting procedures for service outages.⁹ In order to make the most efficient use of the Commission's scarce resources, service quality, network reliability and any associated reporting requirements should continue to be addressed outside of price caps. Quality is more easily independently verifiable than changes in costs. Therefore, quality factors should continue to be monitored "exogenously". That is, the price cap factors themselves should not be adjusted depending upon, for example, whether a LEC satisfies some minimum service quality standard. If incorporated into what should be a financial incentive plan, these types of "quality adjustments" would reward the LEC for doing something that it should be doing regardless of the form of regulation: Improving its service quality and network outage record in pace with the adoption of more robust and reliable technologies.

⁹ Amendment of Part 63 of the Commission's Rules to Provide for Notification by Common Carriers of Service Disruptions, Notice of Proposed Rulemaking (FCC 93-491), December 1, 1993.

Handling these issues outside the LEC price cap plan also supports other objectives that are under review in CC Docket No. 91-273. For example, ICA agrees with the comments submitted by the Tele-Communications Association (TCA) in that docket seeking Commission policies and support to promote universal implementation of telecommunications mutual aid and restoration procedures.¹⁰ These issues clearly implicate the interests of parties other than LECs and thus should continue to be dealt with in proceedings specially focused on the issues.

Baseline Issue 7b: Whether the Commission should expand monitoring to include interconnected facilities, including wireless and coaxial, and what are the administrative and business costs of doing so.

ICA reserves the right to reply to submissions by other parties with respect to this issue. As noted under Issue 7a, new rules regarding monitoring of LEC-interconnected wireless, coaxial or other facilities and monitoring the evolution of the facilities provided by vendors other than LECs deserve to be treated in a separate proceeding focused upon this issue.

Baseline Issue 8a: Do the LEC price cap new services rules impose unnecessary regulatory impediments to the development and introduction of new services; Identify and assess the magnitude of any impediments?

ICA has reviewed the discussion in the Notice concerning LEC complaints that the current rules for "new services" delay the introduction of such services and create unneeded inefficiencies.¹¹ The experiences of many ICA members suggest, however, that many factors besides just the regulatory approval process make it difficult for LECs to introduce new services.¹² Therefore ICA is not

¹⁰ TCA Comments, January 21, 1994, pp. 6-7.

¹¹ Paragraphs 77-80.

¹² The LECs still are less effective in identifying customer requirements and new applications than are vendors, like IXCs or equipment suppliers, operating in more competitive segments of the telecommunications industry.

ready to agree with LEC claims that the regulatory approval process is the major impediment in this area. However, ICA agrees that better rules regarding the treatment of new services could improve the process of introducing such services.

Some of the "delays" in introducing new services of which LECs complain are the product of the LECs' experimentation with many different cost formulations, claims about the "proprietary" nature of cost models and other factors. ICA believes that these issues could be resolved if the Commission were to prescribe the method to be used for identifying costs of new services. The current rule is too vague for this purpose. An assumption that any rate decrease is per se valid tempts LECs to mis-state their incremental costs and erect de facto barriers to the Commission's resale requirements. A number of state regulatory authorities have made good progress in defining fixed rules for incremental cost studies, and the Commission should consider developing the same types of standards.

ICA strenuously disagrees with the proposal in the Notice that merely delaying tariff review until some future time is an appropriate or adequate solution to the issue.¹³ The very rationale advanced in the Notice — i.e., that demand projections for new services are inherently uncertain — states a condition that could persist for several years. If the LEC wished to make changes in rates and rate structure of a new services (as it should have the ability to do, given the uncertainty of demand) the deferred cost showing for a new services would become a moving target. This sort of extraneous regulatory "lag" would do nothing more than increase LECs' incentives to game the process, lead to increased complaints before the Commission and reduce the certainty and stability of prices to users. The Commission's proposal, as it stands, is simply unworkable.

¹³ Paragraphs 82-83. In practice, ICA believes that the "deferred" cost review of new services would never occur, or at least never be concluded. The FCC staff's attention would be diverted to new, more pressing matters when the time for the deferred review was approaching. LECs might make changes to the initial rates or rate structure that would obviate the deferred cost showing.

Therefore, ICA proposes that the Commission utilize a "Price Linking" approach to new services; Attachment B to ICA's comments details this proposal and discusses the new service issue in more detail. The elements of this approach would:

- Require each LEC to calculate a second, surrogate "API" the " API_{ns} " that would parallel each basket, reflecting the embedded services in the basket and all new services based upon three years forecasted demand.
- Where the difference calculated by subtracting the actual API and the surrogate API exceeded two percentage points, reduce the LEC's PCI for this basket by the incremental decrease in the $API-AP_{ns}$ differential.
- Require that the surrogate API_{ns} calculation be updated every quarter to account for changes in actual versus forecasted demand. This is necessary to mitigate LEC incentives to understate demand.

At the same time, the increased discipline that this type of price linking would impose on LECs should allow increased flexibility in other areas. A persistent claim of most LECs is that the existing requirement for individual waivers of specific Part 69 rules is unduly cumbersome and time consuming. LECs have proposed to completely replace most of Part 69 partly to avoid the waiver requirements. The price linking proposal could eliminate the need for the LEC to seek waivers of particular Part 69 rate structure rules for services included in the API_{ns} approach. Services tariffed under this approach could be subject to a separate section in Part 69 that would not affect the other rules.¹⁴ This approach will accelerate the introduction of appropriate new services, but also will require LECs to consider the effects of new services on their existing revenues and earnings, more like firms in competitive markets. Both outcomes will benefit ratepayers.

¹⁴ Of course, Commission consideration of changes in the existing Part 69 rules could proceed at a logical and appropriate pace, keyed to industry and marketplace developments.

Baseline Issue 8b: Whether and if so how the Commission should modify the LEC price cap new service procedures and cost support rules to advance goals of innovation while maintaining reasonable rates?

See above.

Baseline Issue 8c: Whether new services should be available to all LEC customers on an equal basis, and how to ensure universal availability. How widely are the current new service offerings available?

As ICA noted under General Issue 2 and Baseline issue 1, our members strongly discourage unnecessary government involvement in allocation decisions involving telecommunications products and services. ICA supports both the current concept of universal telephone service and a reasonably evolving definition of expanded universal service — but only if, as and when the market development of a service shows that it should be part of a "universal" offering. Universal service may be appropriate for newer services based upon considerations of ubiquity, connectivity and/or affordability, but judgments about these issues must be made strictly on a case-by-case basis.

The Commission may be asking in Issue 8c whether new services should be deployed everywhere technically feasible or only where economically feasible. If this is the question, ICA believes that there must be a cost/benefit test, including perhaps a determination whether there are bona fide requests for the new service where it is not available.

The Commission may also be asking how to ensure that new services are "generally available," under the Commission rules designed to prevent unreasonable price discrimination, and whether resale rules ought to be ensured for new services. If this is the question, ICA supports rules designed to allow resale of services and to make services generally available without customer class restrictions. These issues likely will be addressed in the context of individual tariffs or service offerings, as they have typically been addressed in the past. As noted under issue 8a. and in Attachment B, ICA believes that enforcing greater market discipline with respect to LEC's new service offerings will compliment

other Commission rules regarding resale and unreasonable price discrimination.

Baseline Issue 9a: Whether the current rules regarding AT&T's computation of changes in exogenous access costs should be revised to equalize the treatment of LEC and CAP access rates?

In effectively competitive markets, vendors generally are under pressure to pass on cost savings and quality improvements from their own suppliers to their customers, although these adjustments may not happen instantly or uniformly. ICA has consistently supported regulatory "dollar-for-dollar flow-through" rules for AT&T that would generally match the effects of a competitive market. That is, not only should the savings be flowed through by AT&T but price adjustments among individual services and rate elements should reasonably reflect the causation of the costs (and in this case the savings).

ICA has no evidence currently that AT&T faces different incentives at this point in time regarding costs it incurs from LECs or CAPs or that competitive market incentives are not fully operative with respect to AT&T or other long distance carriers. Such incentives do exist in most segments of the business services market involving large users.

If the Commission believes that the record in this proceeding would support an adjustment to AT&T exogenous cost rules, then the pro rated percentage change in AT&T's average access costs per minute for all switched services (combining access services from the LECs and other providers) should be used as an adjustment only to the basic MTS services. This approach will ensure that the basic, geographically ubiquitous and uniformly priced MTS service price reflects its appropriate share of the change in access costs and will thus establish the proper price relationship with respect to more specialized services and optional calling plans.

Baseline Issue 9b: Whether other rules that relate to LEC price cap regulation should be revised to equalize the treatment of LECs and CAPs?

ICA will carefully evaluate other parties' comments concerning this issue.

Baseline Issue 10: Should waiver rules regarding sales and swaps of exchanges be changed to enhance efficiency incentives under the price cap plan?

ICA generally reserves comment on this issue for possible reply. However, ICA supports the objective that the form or type of regulation to which a specific LEC is subject should not affect decisions about sales or swaps of serving areas. It is clearly inappropriate for price caps and USF considerations to be reflected in business cases of either the selling LEC or its purchaser with respect to transfers of exchange ownership.

Baseline Issue 11: Whether the Commission should adopt baseline revisions to the LEC price cap plan other than those specially discussed?

ICA believes that the baseline price cap plan should include the "pricing linking" mechanism discussed above and in Attachment B to these comments to provide market-like mechanisms for checking prices on new services. ICA reserves the right to address other proposed structural changes in the plan in response to comments submitted by other parties.

Baseline Issue 12: Whether the LEC price cap review should be coordinated with other proceedings and proposals (like Ameritech and Rochester)?

No, not at this time. If one or more of these other proceedings results in a Commission determination or rule that could be generally applied all LECs, or all price cap LECs, then the Commission could propose a general rule by means of a supplemental notice in this proceeding. However, ICA and its members adamantly oppose to any regulatory regime that could create LEC-specific regulatory plans for each area of the country, based upon some variation of what the LEC in that area happened to propose. LEC-specific regulatory plans would make it far more difficult for customers with telecommunications requirements in several different areas of the country to plan and manage those requirements. Most ICA members fit this category.

It is appropriate for the Commission to evaluate proposed price cap reforms and to utilize those features of the plans that (a) adequately balance customer

protection and the development of competition with LECs' strategic interests, and (b) are suitable for application in similar areas of the country, such as urban or suburban areas, throughout the United States. Certain features of the proposals ICA has outlined and/or supported in these comments fit these requirements.

Conclusion

ICA has outlined modifications to the current LEC price cap plan that should make the regulatory mechanism more robust and adaptable to future changes. The Notice also separately specifies several "Transition" issues such as the current state of competition; using selected factors to determine when reduced or streamlined regulation should take place; in what circumstances will LECs no longer control bottleneck facilities; the actual or potential competition from CAPs; and the effects of LEC entry into related industries, such as cable television. ICA also has attempted to consider these issues within its review of Baseline issues. Some of the transitional issues may prove to be too complex or speculative to be resolved in the current proceeding. However, ICA will carefully evaluate other parties comments on these issues. As the world's largest telecommunication user association, ICA commits to work with the Commission to ensure that America's ratepayers receive the maximum benefits possible by appropriately modifying the Commission's LEC interstate price cap plan.